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ABSTRACT

Postsecondary education budgeting by Southern states, the status of formula funding in the region, and changes in determining annual funding needs are examined in this report. Trends emerging in many states include: an overall stabilization of enrollments with wide year-to-year fluctuations possible, both contraction and expansion within state systems, rising costs, and increasing government oversight. While postsecondary systems in the Southern Regional Education Board states have generally established long-range plans, a key issue as the 1980's approach is how to tie budgets to these plans. A central issue to be resolved is whether states will emphasize more quantitative means (formulas) or less quantitative means for fitting budgets to plans. Related concerns of the states are: accommodation to differences between fixed and variable costs; inclusion of an increased sensitivity to differences among the roles of the institutions in a state system; and the ability to respond efficiently and effectively to more detailed budget reviews by state government, while maintaining budgetary flexibility. (SW)

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Financing Higher Education

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Budgeting of Postsecondary Education in the Eighties

How do Southern states budget for their colleges and universities? What is the status of formula funding in the region? What changes are taking place in determining annual funding needs? These kinds of questions are receiving more attention as the number of 18 to 24 year olds declines and enrollment growth levels off.

While declines in postsecondary enrollment are not expected to become pronounced until the early 1980s, the elementary and secondary education sectors have already been hit by decreases. According to a recent study of elementary and secondary schools by the National Institute of Education, *Declining Enrollment: The Challenge of the Coming Decade*, "Enrollment dropped in 36 states between 1971 and 1976, but the cost of school operations rose sharply in all 50 states at the same time. Enrollment dropped 2.3 percent nationwide while costs were rising 56 percent during the period." The study said there are two popular theories on how declining enrollment will affect education:

- ☐ That it will be highly disruptive to quality because of unmanageable revenue shortfalls and other problems.
- ☐ That it will actually result in long-sought improvements through smaller classes and equalized funding.

The report goes on to note that recent research challenges both of these views. It finds, instead, that "declining enrollment has had very mixed effects, and overall, has failed thus far to provoke any major shifts in the quality and character of local school services."

By the start of the 1980s, postsecondary education systems in the SREB states will be responding to conditions similar to those now faced by the elementary and secondary schools. Several of these trends are already emerging in many of the states:

1) ***Overall stabilization of enrollments with wide year-to-year fluctuations possible***
As the number of 18 to 24 year olds reaches a plateau, any gains in enrollments are less likely to come from greater college-going rates by the traditional age group and are more likely to come from older groups in the population. These nontraditional learners tend to enroll part-time and on a less consistent basis than traditional college-age students. The attendance of older groups is influenced more by external factors, such as the economy and special legislation accommodating to their needs. Since it takes several part-time students to generate the same income as one full-time student, the greater participation of older groups will not necessarily redress the financial effects of the decline in the numbers of traditional college-age students.

2) ***Both contraction and expansion within state systems***
While total enrollment over an entire state system may stabilize, some institutions or programs may contract while others expand. Factors such as location, the occupational relevance of programs, and tuition levels will affect which institutions gain or lose enrollment as women, older, and part-time students become larger parts of total enrollment. New kinds of students will tend to enroll in urban institutions, in occupationally-linked programs, and in institutions with lower tuition.

3) ***Rising costs***
Costs for higher education, regardless of inflation, may increase more than in other sectors of the economy. Higher education, like other service sectors, has not been able to increase productivity enough to offset increases in salaries and benefits; this has led to higher average costs per student. Also, qualitative improvements, increased administrative and external reporting requirements, mandatory social programs, and remedial and financial aid programs for students all point to more costs each year.

4) ***Increasing government oversight***
Both the legislative and executive branches are increasing the intensity with which their staffs review budgets for postsecondary education systems. Part of this increased oversight may be due to the expansion and maturation of staffs. However, most can probably be attributed to the

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public's call for greater accountability from all state programs as priorities multiply faster than resources.

5) ***"Proposition 13" issue***
As the 1980s approach, state governments are hearing increased calls for limiting taxes on personal income and property—major sources of state revenue. This stems in part from the public feeling that government has grown too much and is feeding its own further expansion. Since postsecondary education is a highly discretionary item in many state budgets, the effect may be for total resources for its support to stabilize as competition with other state services increases. Those community colleges which depend largely on local funding for support may be particularly jeopardized by property tax restrictions.

Responsibilities of the State Higher Education Agencies

In the statewide budgetary process for higher education, the way in which requests are made by higher education to the legislature and how the executive and legislative branches act on these requests are critical.

Of special importance is how state systems of postsecondary education in the South are modifying their procedures for requesting appropriations in light of new conditions. While the executive and legislative process of acting on these requests is not examined, the ways in which the request process changes will certainly influence these actions. The two parts of the process—the requesting and the granting—interact, so that it is not unreasonable to find that changes in how higher education asks for budgets will reflect, and also determine, the way in which government decides what part of the request will be granted.

State systems of postsecondary education in the South will be addressing these emerging conditions in the immediate future. Most state higher education agencies have already adopted long-range planning as the primary technique to bring order to their systems' changing profiles through the next decade. The more comprehensive plans provide guidance for the overall role and scope of each institution in a system as a way to minimize unnecessary program duplication.

If the higher education budget is tied to a state's long-range plan, a clear definition of institutional role and scope also should lead to more effective use of a state's financial resources. Many states are now assessing ways in which their budgeting procedures can be modified to enable a more direct fit of budgeted resources to the planned pattern of institutional roles.

In weighing changes in the budgeting request process, the state agencies differ in their responses. The basic issue, whose resolution will determine the kind of budgeting to be used, concerns how a state will characterize the elements of its long-range plan as a basis for guiding the budgeting process. Some SREB states translate their plans in quantitative terms through mathematical formulas. Other states are choosing to fit their budgets to their plans through reliance on less quantitative approaches.

It is clear that the budgeting procedures of a state agency for its postsecondary educational system will depend in part on the kind of authority which resides in the agency. In the 14-state SREB region, nine states have agencies with coordinating or regulatory powers; agencies in five states have governing authority. All of the coordinating agencies rely on formulas as a central part of their budgeting process, while governing agencies use these quantitative tools to a lesser extent. Of the five governing agencies, three use some kind of formula funding, one uses formula-type informal guidelines, while another state operates without formulas.

The greater reliance on formulas in the states without governing authority may be due to a greater need by the coordinating agency to be viewed as completely objective in budgeting by both state government and the institutions. For most coordinating agencies this perception is critical, for they must rely on the good will and cooperation of the system's institutions for implementation of plans, and on the support of the executive branch and legislature, rather than on governing authority. When the power to govern is introduced, an agency may have more latitude in which to build a budgeting process that does not depend on mathematical objectivity. Of course, a governing board values a perception of equity and seeks it, but not necessarily through quantitative means. Since the governing board is identified with the institutions, it does not have to be as concerned with being neutral or reaching an objective sense of equity as defined by both state government and the institutions.

As each kind of state agency responds to the tightening conditions ahead, a major issue becomes how the state agency will mold its budgeting procedures to express accurately its plan for higher education. Will there be more reliance on quantitative indexes by adding more formula detail, or will less quantitative procedures be used to finance a system's blueprint for orderly progress?

Formula Funding

Formulas are quantitative statements that prescribe how to build a request for funding, while maintaining balance among a state's institutions, programs, and budgetary functions. While many states use formulas to construct a funding request, few use formulas to distribute the final appropriation.

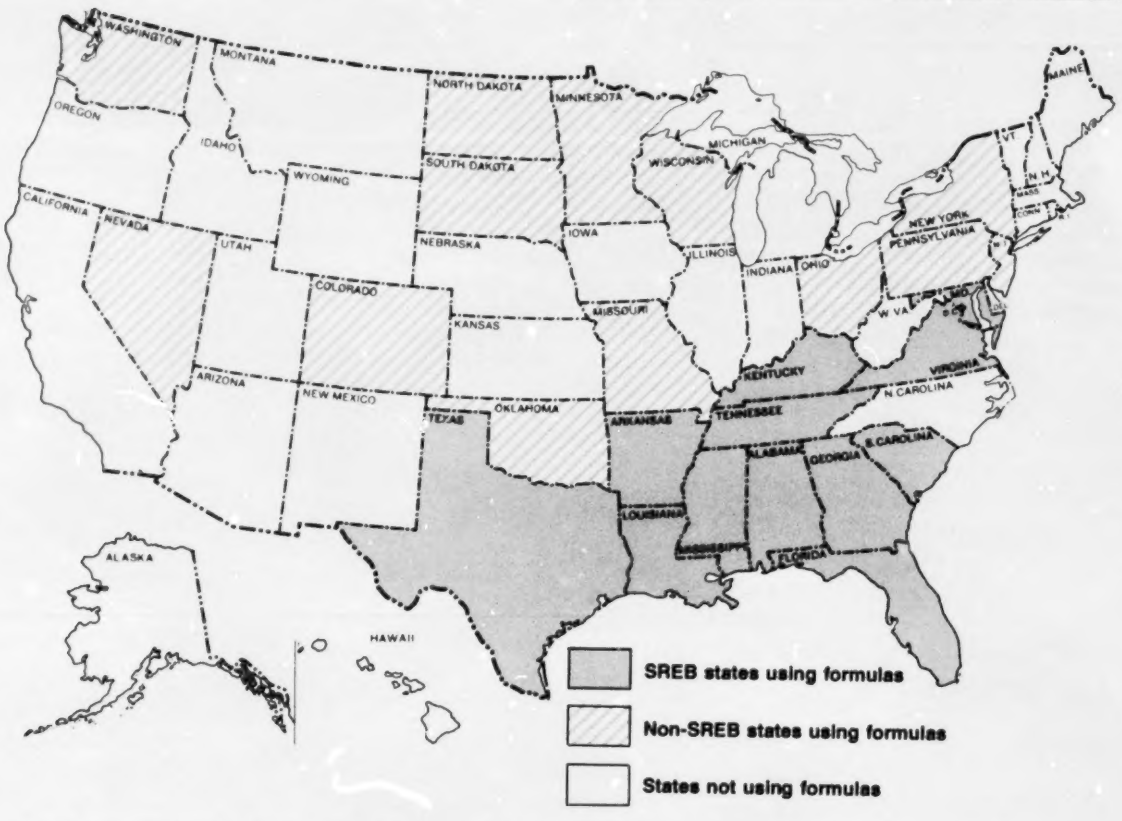
A formula calls for a specific amount of money to be given for each unit produced. For instance, a formula for generating dollars for instruction in a college could stipulate that for every credit hour, $20.00 will be added, or that for certain numbers of students one teacher will be funded at a given salary rate. Normally the rate, or the dollars per unit, is the same

across all institutions. Institutions generate different total dollars because the number of units that are combined with the rates differs across institutions.

The formula process can be applied to other budgetary areas besides instruction. Some of the simpler formulas determine other parts of the institutional budget, such as academic support, student services, institutional support, libraries, and plant operation and maintenance, by taking a percentage of the previously established instructional total. Other more complex systems of formulas have separate equations for each of these other budget areas, with different rates and kinds of units. For example, plant maintenance may be based on the square feet to be maintained, and plant operation may have rates and usage estimates for funding utility costs. Moreover, even within a single budget area, there may be more than one kind of formula. For example, in instruction, while credit hour or enrollment data will be used to "drive" the formula, the rates may vary across programs (separate rates for biology, history, English, etc.) or by level of instruction (*e.g.*, undergraduate, master's, doctoral, and professional). Within the library area, there may be different bases, one based on enrollment and another based on number of faculty, each with its own rate. Some states have different formulas by kind or level of institution (*e.g.*, university, senior college, two-year college). All formulas are explicit in determination of so many dollars for a specific unit, and they may be as detailed as desired.

Before turning to the issues presented by formulas as finances and enrollments change for postsecondary education, it would be well to mention the historical reasons for using formulas. Formulas became popular during times when state systems were growing. One motive for a state shifting to formula budgeting was to insure each institution in a system an equitable share of state funds for student instruction, research, and public service. In most cases the need for a system to make budgeting seem more objective or rational was the original reason for states moving to a formula process. Formulas also provided objective criteria for legislative and executive budget

Figure 1
Formula Utilization in the United States



Source: Gross, Francis M. "A Comparativc Analysis of the Existing Budget Formulas Used for Justifying Budget Requests or Allocating Funds for the Operating Expenses of State-Supported Colleges and Universities." University of Tennessee, 1973.

staff and state agencies in responding to budget requests from a system's institutions.

A second reason for formulas concerns the need to insure a base level of support each year. A formula helps to build this sense of adequacy by making explicit the key elements in the budget process and increasing the likelihood that similar elements or processes will be a part of the results. Even during statewide austerity, institutions are assured of receiving at least minimal base funding in relation to other governmental concerns.

In the South, formulas are now prevalent, and are used by 12 of the 14 SREB states. As of 1973, only 13 of the remaining 36 states were using formulas (Figure 1). The reason for the great popularity in the South may be the existence of a large number of states having several major institutions, rather than just one large scale university. A rough analysis reveals that many non-formula states have only one major institution in their public system, due either to their low population (*e.g.*, Arizona, Idaho, Montana, Wyoming) or because of a large number of private institutions (New England states). Formula budgeting seems to have grown more often in states that have a larger number of somewhat similar institutions requiring state resources, which prompts the need for a more objective and rational way to fund the institutions with these more or less equal claims.

Current Issues in Statewide Budgeting of Postsecondary Education

The prime question is how states can develop budgeting procedures that will enable an accurate translation of the state's long-range plan for guiding postsecondary education through the new conditions of the 1980s. A central issue to be resolved is whether states will emphasize *more quantitative* means (formulas) or *less quantitative* means for fitting budgets to plans. This resolution in turn may depend on how state agencies will modify their budgeting processes to reflect the following concerns:

1) accommodation to differences between fixed and variable costs;

2) inclusion of an increased sensitivity to differences among the roles of the institutions in a state system;

3) ability to respond efficiently and effectively to more detailed budget reviews by state government, while maintaining budgetary flexibility.

Advocates of formula budgeting point out that the reasons for adopting formula systems in the first place—namely to insure adequate base support and a fair share of state resources for higher education—still exist as a state system moves from growth to stability or decline. There is a need for an objective, rational way to budget higher education institutions to insure fairness and adequacy among the institutions. In fact, the need for objectivity may even be greater as additional rationales for funding are developed.

Other states that do not use formulas at all, or as much, believe that their non-formula, less quantitatively-based procedures provide greater flexibility to new circumstances, as higher education enrollments begin to stabilize.

Sensitivity to Fixed and Variable Costs

Marginal and average costing become subjects of increasing concern during a time of enrollment stabilization or decline.

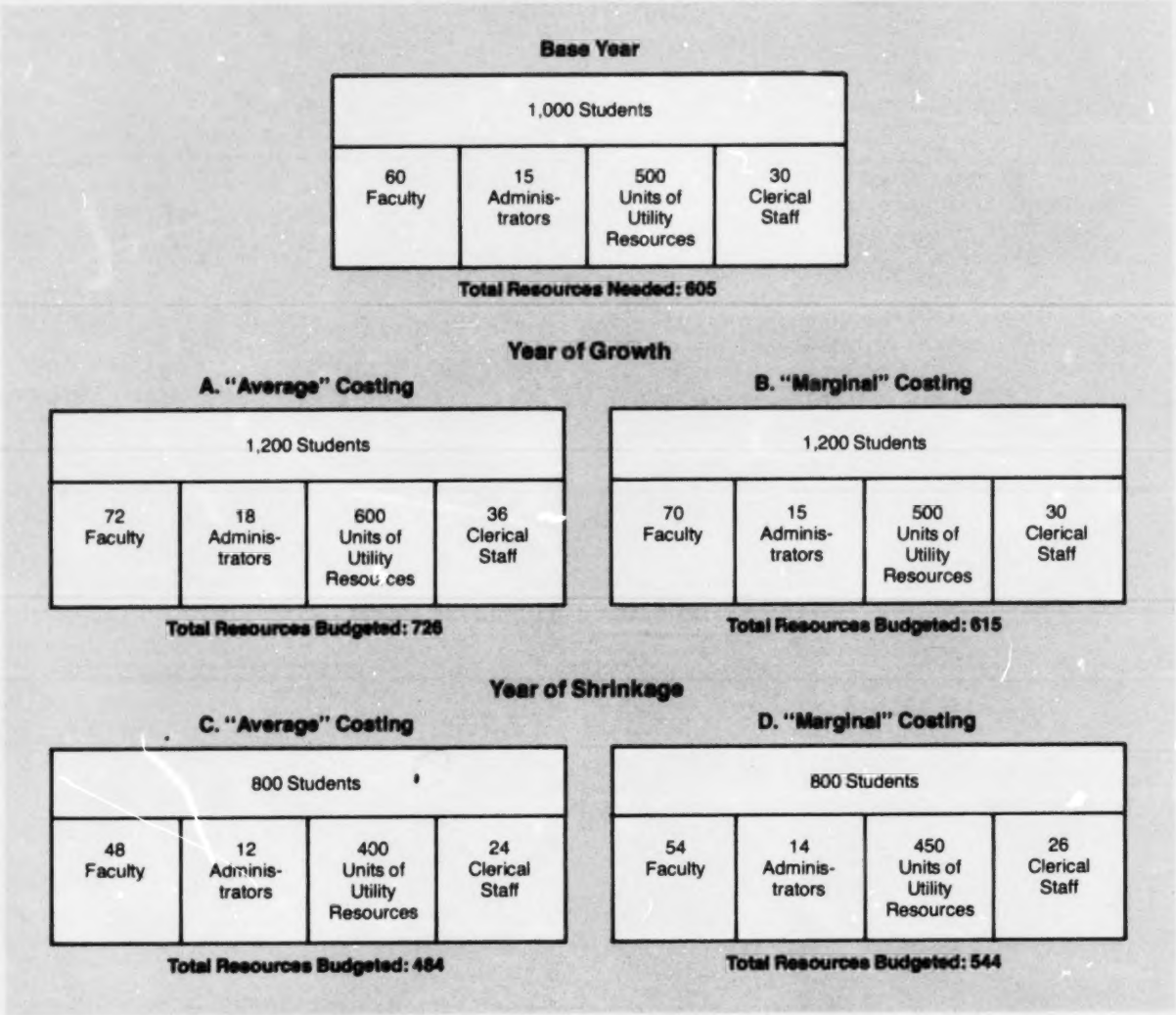
Marginal and average funding are different ways for deciding how numbers of resources should change to reflect fluctuations in the numbers of students or some other output. It is useful to consider the marginal and average concepts by focusing on the actual numbers of resources needed to produce a certain number of outcomes, rather than on the costs of those resources. Considering only costs clouds the relationships of resources to outcomes, as inflation increases costs each year whether or not the number of resources increases. It is important in discussing higher education funding to realize that, because inflation decreases purchasing power, total costs will probably continually rise even if numbers of resources used remain constant or decrease.

As enrollment changes, the key question in the funding process is how should the volume of resources change. As enrollment grows, using *average* resources per student to ask for additional resources involves determining the relationship between the original number of students and total resources of all kinds, calculating an average resource use for each student, and then applying this index to each of the additional students. This implies that resources of all kinds will be increased at a rate identical with enrollment growth (A in Figure 2).

Budgeting resources to reflect enrollment changes through application of the *marginal* concept recognizes that the number of resources does not have to change at the same rate as the number of students (B in Figure 2). Without increasing their numbers, some kinds of resources, such as buildings, administrators, and equipment, can accommodate extra students without increases in their number. Within limits, faculty might even be asked to teach additional students. As enrollment grows, the marginal allocation of resources takes advantage of this potential increase in resource productivity by identifying what resources can accommodate extra students without increases in their number or at a rate of increase that is less than the student growth rate. These resources are said to be fixed.

Those remaining resources, which must be increased to correspond with the increase in enrollment, are referred to as variable. In determining the total number of resources to be added to meet the enrollment increase, only the resources known to vary are included. The overall result is that the growth rate in the actual number of total resources

Alternate Approaches to Budgeting



budgeted is less than the growth rate of enrollment.

Whether resources are allocated on an average or marginal basis is especially critical as enrollments decline. Using *averages* assumes that all resources vary with enrollment, leading to equal rates of decline in number of resources and enrollment (C in Figure 2). The *marginal* basis, however, recognizes that some kinds of resources cannot be cut back at the same rate as enrollments decline, while others can be (D in Figure 2). Overall, this leads to a lesser decrease in resources than is the case in using averages.

The usual way to describe the relationship of quantities of resources to enrollment changes is through the costs of those resources. The change in the costs of the resources, not counting inflation, is related to enrollment change. The Indiana Commission on Higher Education recently estimated these relationships for several different kinds of resources (Figure 3). The relationships between costs and enrollment changes over a short time (one to five years) were graded on a scale ranging from completely variable to totally fixed. Semi-variable denotes that part of a cost is variable (changes at same rate as enrollment) and part is fixed (no change as enrollment changes).

Several SREB states are revising their formulas in ways that acknowledge the existence of fixed and variable resources and associated costs. This involves establishing separate formulas for different kinds of resources, geared to bases that are different from enrollment. For example, most of the SREB formula states use something other than enrollment as the base on which funds are generated for plant operation and maintenance. Several states have more than one kind of base for this single area. These practices illustrate that enrollment is not the only influence on total institutional budgets.

A further example of how states on the formula system of budgeting are dealing with marginal costs comes in the area of institutional support, which includes such services as executive and fiscal management, general administrative, logistical, and public relations services. Seven of the 12 SREB formula states establish sliding dollar rates per student for different enrollment ranges. As enrollment grows, the rate per student decreases. The result is that resources in this budgetary area are increased at a rate lesser than the rate of enrollment increase.

The net effect of applying formula systems that vary the relationships of different kinds of resources to enrollment increase is to put budgeting on a marginal cost rather than an average cost basis. Taking action when enrollments are still increasing may soften the blow of declining enrollments in the years ahead by applying the same marginal costing concepts to the reverse situation when enrollments decline.

Figure 3

Estimates of the Variability of Costs by Indiana Commission on Higher Education

	Variable	Semi-Variable		Fixed
		High	Medium Low	
Instruction				
Teaching Salaries	X			
Academic Support Staff Salaries		X		
Academic Departmental Supplies and Expense		X		
Other Faculty Salaries (Research, Administration)			X	
Academic Administration (Department Heads, Deans, etc.)				X
Non-Instruction				
Sponsored Research				X
Public Service				X
Libraries			X	
Student Service			X	
General Administration			X	
Institutional Support			X	
Physical Plant				X

	Percent of Cost Assumed to be Variable
Faculty Salaries attributable to teaching (65% of total faculty salary costs)	100%
Other Faculty Salaries (Research, Administration) (35% of total faculty salary costs)	10%
Academic Support Staff Salaries	40%
Instructional Supplies and Expense	40%
Academic Support	25%
Institutional Support	5%

There are good reasons to believe that some resource costs which are highly related to enrollment during growth are not as subject to being varied downward as enrollments decline, namely those of faculty with tenure and long-term contracts. At the very least, detailed formulas can recognize that some resource areas of a more fixed variety, such as utilities and operation and maintenance, must decrease at lesser rates than enrollments. Several formula states in the SREB region are taking steps that will prepare them for the time when growth turns to stability for individual institutions or for an entire system, and funders question why resources "should not come off in the same way they went on." Presumably, these states will be able to call on existing procedures that have already laid the basis for budgets to be built on foundations other than enrollment.

On the other hand, objective formulas are only one means for adapting to slower growth. Two state higher education systems in the region, which do not rely on formula processes in developing their budgets, believe that their current procedures will serve as well in stability as during growth. Much of the adaptability of these procedures can be viewed as a subjective or informal use of marginal costing principles.

The marginal costing idea is implemented in these states by first establishing that all or at least definite parts of last year's budget will be carried over, while any additions to last year's budget will be open to discussion and may vary. The carry-over or continuing budget is usually composed of last year's budget plus the total for personnel pay increases. With this as a base, the variable part of the budget is developed through reference to a variety of factors including enrollment changes, qualitative improvements, new and expanded programs, capital improvements, etc. In this phase, one of the non-formula states (West Virginia) uses rough ratios based on enrollment and other percentage indicators to establish ceiling guidelines. North Carolina, on the other hand, collects requests for new expenditures from each institution and places priorities on these requests from the perspective of the total system.

In arriving at a total budget, both states emphasize that the total will depend only in part on the rate of enrollment change. West Virginia, which uses guidelines based on enrollment changes, attempts to reach a fair figure through discussions with each institution. During times of increasing enrollment, this figure may be more than last year's base budget plus pay increases, but probably less than that indicated through strict reliance on the guidelines based on average cost per student. However, for institutions that lose enrollment, this process allows for last year's base budget, or at least most of it, to be maintained. The enrollment-based guidelines may call for no increase in the variable part of the budget, or perhaps even a decrease from the last year's budget, not counting inflation. But the concept of marginal cost, as applied through the subjective judgments of the budgeters, allows that an institution losing enrollment cannot decrease its resources on an average cost basis, just as its resources do not have to increase at the pace of enrollment increases.

A further way that marginal costing may be applied by state agencies to conditions of no-growth without using formulas is by tying budget increases in the incremental (non-continuing) part of budgets to non-enrollment related items. In North Carolina, budget increases have been based on such factors as new programs, removal of deficiencies, improvement

of quality, changes in priorities, etc. By emphasizing not just enrollment but various other factors as bases for increases over last year's budget, a diverse and credible foundation for justifying future increases has been established. If enrollments were only part of the picture in the growing 1970s, it is held that the same should be true in the stable 1980s.

Role Differentiation of Institutions

As enrollments and financial resources stabilize, long-range planning becomes increasingly important as a strategic method through which a state system moves into the future. A key element of these plans is the more detailed differentiation of the roles of each institution in a system. But while long-range plans may establish and keep open options, a system constantly "enters the future" through shorter-range budgetary decisions. An important issue is how budgets can be tied to and reflect the greater detail and differentiation of long-range plans.

People who feel that formula budgeting is the best means of responding to stabilization argue that formulas can be sufficiently detailed to capture the role differences between a system's institutions, thus maintaining the valued objectivity and visible rationality of a formula system.

There are several ways by which states have been adapting formulas to effect the planned differences in institutional roles. In deriving instructional budgets, different dollar rates are used for different disciplines, student levels and institutional types. The more complex instructional formulas have well over 100 different instructional rates. These rates are then applied to the enrollment for each category. While the objectivity of the formula process insures that like categories will be funded similarly (at the same rate) when entire institutions are compared, institutional differences will be apparent because enrollment will concentrate in different programs across institutions. Total costs will vary because funding follows those enrollment differences.

In addition to instruction, some current formulas also differentiate institutions with respect to the research and library functions. Kentucky and Texas employ distinct formulas for generating some state support for individual faculty research. The formula generates an "institutional complexity factor" by weighting and combining enrollment in three different categories of disciplines. This complexity factor indicates the degree of research orientation in the institution. The index is multiplied by (a) total faculty compensation and (b) sponsored research funds in the institution.

Further examples of how a formula can be sensitive to institutional differences are provided by the Florida and Virginia library formulas. In part, Florida relates budgets for new volumes to the number of graduate programs. Virginia categorizes its institutions into three groups and establishes a distinctive formula for staffing its research universities.

Perhaps the capacity of formulas to reflect the greater differentiation among institutions can best be seen in the Kentucky Council for Higher Education formula adaptation to new institutional roles. As part of its instructional formula, rates for faculty compensation are derived by reference to out-of-state benchmark institutions. There are four groups of benchmark institutions, paralleling the four basic categories by which the Council has classified each institution's role.

Thus, one response to budgeting during stabilizing enrollment and to the increased demand for clearer institutional roles may be through the use of more detailed formulas that are sensitive to institutional variations. Formula advocates feel such sensitivity can be quantified.

The two non-formula states in the region (North Carolina and West Virginia) practice a more subjective system of budgeting for a more differentiated system. A complex weighing of institutional goals, current progress toward these objectives, the nature, mix and amount of resources needed to make further progress, and how the resources budgeted for one institution will offset those available to other institutions in the system provides the basis for budgetary judgments in these states. Thus, it is emphasized that lower division English at the University of North Carolina at Chapel Hill is a very different division than at UNC-Asheville, and that a budget should reflect this distinction. The reasons for the difference can be traced to the goals, expectations, and activities of the institutions and their faculty. This point of view acknowledges that formulas might be constructed in enough detail to reflect the basic differences among institutions, but that this would necessitate a separate formula for the same programs in each institution—a practice that would seem to deny one purpose of formulas, which is to provide a single rationale for funding similar programs in institutions in a system.

Budget Review

The 1970s have been notable for a pronounced intensification of legislative and executive reviews of budgets. As the 1980s approach, state government staffs will become even more adept at budget review, and postsecondary education systems will be competing even more strongly for state resources, with the added handicap of a decreased rate of enrollment growth.

There are two kinds of budget reviews—one emphasizing the justification of requests, the other centering on audits of actual expenditures (accountability). Until now, budget review in postsecondary education conducted by the legislative or executive branches has focused on the requesting phase. However, it is felt by some that, as resources tighten statewide and priorities mount, there will be pressure for state government to audit actual expenditure details. Most would agree that there is a point at which accountability turns into control and threatens institutional autonomy. While that point may not be precisely known (and perhaps changes

with the times), it is felt that statewide planning and budgeting procedures should include some safeguards of institutional autonomy.

In defining how or what budgeting procedures best allow for these twin needs for institutional autonomy and accountability to state government, it is useful again to assess the differences between states that use formulas and states that do not. States using formulas see them as providing criteria which are clear, rational and objective for request purposes. This objectivity may be seen to benefit state government and institutions alike.

Of course, it is possible that procedures used to request budgets could also be used to review actual expenditures. It is true that in most states which use formulas there is no expectation or requirement that the dollars generated by formula be allocated according to the detailed categories of the formulas. However, it is pointed out that the potential is there for budget reviewers to call for an accounting of the formula-generated dollars—using the formula categories. In Virginia, for example, there have been moves by the executive branch to improve the match between actual faculty positions filled at a certain salary level with the number of positions generated by the formula across the state system.

While coordinating-type agencies usually do not have the authority to authorize how the money will be spent, governing agencies do. The state agencies with governing authority which do not use formulas feel that they already are required to exhibit a high level of correspondence between asking and spending budgets, without introducing further detail through formulas. In North Carolina, there is a great deal of control as budgets are prepared and expenditures reviewed according to both line item and program detail. In addition, the University of North Carolina System is expected to send back any funds not spent on the specific item budgeted. This correlation between budgets and expenditures presents a very different basis with which to approach the increase in budget review activities ahead. Against this background, North Carolina and West Virginia, with governing agencies, view formulas as providing only another potential layer of budget detail for review.

Conclusion

As state systems of postsecondary education approach a decade of relative stability in enrollment and finances, ways must be found to maintain quality and support at effective levels. Certainly, long-range planning is the overall basis for guiding higher education through the period ahead. While statewide systems have generally established long-range plans, a key issue as the 1980s approach becomes one of how to tie budgets to these plans, for it is the budget which gives life to a plan. Given the structure and authority of their educational systems, each state must continue to refine its budgeting procedures to fit more detailed long-range plans, decreased rates of enrollment growth, and more intensive reviews of budgets.

For Further Reading

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